

Capital Formation in Telecommunications

**U. S. House of Representatives
Committee on Financial Services
Subcommittee on Domestic Monetary Policy,
Technology and Economic Growth**

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- **Solutions - Focused**
 - Working with high growth, smaller private businesses
 - Assist in prioritizing opportunities and managing risks of growth
- **Expert – Activist**
 - Focus on specific sectors of the economy
 - Develop financial, operational and regulatory expertise
 - Actively apply to portfolio companies
- **Fundamental Investment Thesis**
 - Trade upside for less speculative, more stable path to value creation



MCG **Background**

- **Current investment portfolio of \$675 mm**
 - 25% in telecommunications
 - Remainder in Media, Information Services and Technology
- **Recently completed IPO and Bond Offering**
 - Capital Markets validation of investment thesis
- **Active investor for over 10 years**
 - Deployed over \$2B in capital in over 200 transactions since 1990



**MCG's
Investment
Activities**

- **Fundamentals**
- **Growth**
- **Cash Flow**
- **Collateral Value**



**MCG's
Telecomm-
unications
Investment
Activity**

- **Long Distance**
- **Niche Markets**
 - Prepaid; conference calling; hospitality
- **Integrated Services**
 - Local-long distance-data bundling; messaging
- **Support Infrastructure**
- **UNE-P CLEC**



- **High Net Present Value Customer Acquisition**
- **Predictable Revenues**
- **GPM that supports S, G & A and a return on capital within an appropriate time value of money framework**
- **Discernable ROI on facilities**

Attraction of the Market

- **Favorable Regulatory Environment**
 - Telecom Act of 1996
- **Significant Price/Value Proposition**
 - Greatest value proposition to small business and residential customers; many customers
- **Smaller competitors can outperform**
 - Better at basics- customer service; billing clarity; provisioning
 - Innovation encouraged by competition



Created Attractive Framework for Multiple Entry Strategies

- **Total Service Resale – retail minus**
 - new entrant as marketing and billing agent
- **Facilities – significant PP&E investment**
 - use components of public switched network
- **UNE-P – network elements recombined**
 - Cost plus that facilitates innovation

- **Seemingly low cost entry strategy**
- **Investment capital to acquire customers**
- **Customer acquisition model is critical**
- **Low gross profit margin**
- **Long time frame to ROI**

Facilities

- **Significant entry costs**
- **Reliant on favorable access terms**
- **Long scaling time frame**
- **High gross margin upon reaching scale**
- **Target high margin; larger users**



- **Low cost market entry**
- **Shorter payback on customer acquisition**
- **Viable gross margins with moderate scaling**
- **Capital expenditures focus on customer**
- **Creates framework for product/service innovation**
- **Stepping stone to the high margin facilities**

Have to support all three entry models:

- **Ubiquity of resale**
- **Opportunity for innovation, effective service for average customer and more stable and visible path to profitability of UNE-P**
- **Facilities strategies to serve the most complex customers and generate highest margins**

The three together will facilitate capital formation



What Happened?

- **Capital markets went for the brass ring**
 - **Total market size and valuation creation opportunity created speculative bubble**
 - **Ignored rational stepped framework that was established in the Act**
 - **Don't throw the baby out with the bath water**



What's Next?

Is there still a reason to force the incumbents to keep open all three entry strategies?

FCC's Triennial Review Proceeding will determine outcomes



Public Interest

- Nobody is going to build de novo networks to serve the small guy – competitive telephony as configured allows all to benefit as each strategy flourishes over time



Buy Rate

- **The incumbents need to be held to cost studies so the buy rates on the public switched network elements can support a margin that perpetuates capital in-flows**



Enforcement

- Old monopolies die hard and as such enforcement mechanics should not be undermined
- Tauzin-Dingell appears to created a protected safe harbor for the Bells to invest in next generation networks that won't be subject to open access as provided for by the Act



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